Leprino Foods

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January 7, 2002

Office of the Hearing Clerk
United States Department of Agriculture
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Washington, D.C. 20250

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In re: Milk in the Central Marketing Area
United States Department Of Agriculture Public Hearing On Pooling and Related Provisions
Docket Nos AO-313-A44; DA-01-07

LEPRINO FOODS COMPANY'S POST-HEARING BRIEF

Please find attached Leprino Foods Company's brief for the above captioned matter. If there are any problems in receiving this transmission, please call Duane Banderob at 303-480-2618.

UNITED STATES DEPARTMENT OF AGRICULTURE

AGRICULTURAL MARKETING SERVICE

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IN RE:)
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MILK IN THE CENTRAL)
MARKETING AREA;) **Docket Nos**
PROPOSED AMENDMENTS TO) **AO-313-A44;**
TENTATIVE MARKETING) **DA-01-07**
AGREEMENT AND ORDER)

LEPRINO FOODS COMPANY'S BRIEF IN REGARDS TO PROPOSALS THAT WOULD AMEND CERTAIN POOLING AND RELATED PROVISIONS OF THE CENTRAL ORDER

There is pending before the United States Department of Agriculture ("Department") a proposal to modify the partial payment rate to producers and cooperative associations for milk received. A hearing was held November 14 and 15 in Kansas City, Missouri ("Hearing") to consider this proposal, and others, that would amend certain pooling and related provisions of the Central Order. Leprino Foods Company ("Leprino") operates four mozzarella manufacturing facilities that receive milk regulated by the Central Milk Marketing Order ("Order") to be amended by this rulemaking proceeding. These facilities are located in Fort Morgan, Colorado, and Dodge, Hartington, and Ravenna, Nebraska. Therefore, Leprino has a vested interest in the outcome of these proceedings. Leprino is submitting this Brief to assist the Department in its analysis of the testimony provided at the Hearing related specifically to Proposal 6.

Proposal 6, as advocated by its proponents at the Hearing, is a proposal to increase the partial payment rate from the lowest class price for the preceding month to 105 percent of that price. Proposal 6 should not be adopted. In fact, the evidence presented at the Hearing supports the following conclusions:

A. The proposed change in the partial payment rate does not result in an advance payment that more closely resembles the actual uniform price, and it does not provide a more consistent cash flow than the current system, two objectives outlined by the proponents (Hollon (DFA), Tr. 569).

   1. Had Proposal 6 been in place, the monthly differences between the partial payment and the statistical uniform price would have ranged from an

"underpayment" of $2.38 to an "overpayment" of $1.45 over the 22 month period analyzed (January 2000 - October 2001), a clear indication that the proposed partial payment does not emulate the final payment (Banderob (Leprino), Tr. 586). In fact, the total range between the largest underpayment and the largest overpayment increases from $3.48 using the current partial payment rate to $3.83 under Proposal 6 for the period analyzed.

2. The standard deviation of the differences between the partial payment price and the uniform price is increased from $0.78 per cwt. under the current system to $0.83 per cwt. under Proposal 6 (Banderob (Leprino), Tr. 586). This also contradicts the proponents' suggestion that Proposal 6 improves the consistency of producer cash flow and creates a partial payment that more closely resembles the statistical uniform price.

B. The proponent's conclusion that measures implemented as part of Order Reform in January 2000 fundamentally changed the relationship between the partial payment and the uniform price is wrong. It appears that this erroneous conclusion is based upon a period that is not representative of future price relationships (Banderob (Leprino), Tr. 591, 593).

1. The generally upward market trend during the post-reform period analyzed by the proponents contributed to a larger difference between the partial payment and the uniform price than during the base period. The difference between the partial payment and the uniform price is greater in an upward market than in a downward market due to the use of the prior month's manufacturing value to set the partial payment. Specifically, the partial payment price and uniform price converge in declining markets (that is, the partial payment price as a percent of the uniform prices increases) and, conversely, these prices diverge in upward moving markets. In 14 of the 22 months (about 64%) since Order Reform, the statistical uniform price increased from the prior month, whereas in the previous three years the statistical uniform price increased from the prior month in 21 of the 36 months (about 58%). There is no reason to believe that Order Reform will result over the long term in a higher frequency of upward markets than was experienced prior to reform. Therefore, the post-reform period analyzed is not representative of long term price relationships.

2. An additional factor contributing to the increased spread between the partial payment and the uniform price during the post-reform period is the comparatively high Class IV price relative to the Class III price. In 19 of the first 22 months of Order Reform, the Class IV price was greater than the Class III price. This relationship is the result of extraordinarily depressed cheese prices throughout 2000 (driving down Class III prices) and the dairy price support program supporting nonfat dry milk prices at above market clearing levels

(driving up Class IV prices). The cheese values of 2000 are clearly an anomaly, and the support program influence on Class IV prices was reduced in mid-2001 by an adjustment in the nonfat and butter support prices. The return of cheese values to their historic range and the reduction in the artificial enhancement of nonfat dry milk prices by the support program will reduce the difference between the partial payment and the uniform price relative to the difference experienced during the period referenced by the proponents.

C. Proposal 6 violates two basic tenets of pricing for milk manufactured into Class III and IV products. These tenets are (i) Federal Milk Marketing Orders should establish minimum prices, and (ii) that because manufactured products are marketed nationally, the minimum regulated price level for Classes III and IV should be consistent across all Orders. Adoption of Proposal 6 would result in manufacturers of products in the lowest Class, and in many months in the lowest two Classes, paying more than the classified value of their milk in the partial payment. As to the second tenet, while a couple of Orders employ a prepayment rate in excess of a processor's minimum Class obligation, the majority do not and should not.

During the Hearing, questions were posed regarding the number of days between the time raw milk is received at a Leprino plant and the date payment is received for the cheese and whey products produced from that milk. This answer is important because it focuses on the reality that sellers of products, including Leprino, must wait for payment for the finished products long after the raw materials were purchased. In the Order, sellers of milk to cheesemakers receive payment within 19 days, on average, of delivering milk. Conversely, after converting raw milk into finished products, cheesemakers must store those products, sell the products, ship the products, and then wait until payments from buyers are received. Leprino receives payment for cheese and whey products 57 days, on average, after the raw milk that is used to produce those finished products is first received by a plant.

Respectfully submitted,

Duane Banderob
Dairy Economist
Leprino Foods Company